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SURFACE TRANSPORTATION BOARD

DECISION

STB Finance Docket No. 34319

CONSOLIDATED RAIL CORPORATION —
DECLARATORY ORDER PROCEEDING

Decided: October 10, 2003

The Board is instituting a declaratory order proceeding to resolve a 49 U.S.C. 11321(a) "preemption" controversy between Consolidated Rail Corporation (Conrail or CRC) and AT&T Communications, Inc. (AT&T), and is establishing a procedural schedule for the submission of further evidence and argument.

BACKGROUND

License Agreement. Conrail asserts that, as of June 1, 1999, the preemptive power of 49 U.S.C. 11321(a) immunizes it from certain obligations to AT&T. The preemption controversy at issue concerns a License Agreement that was entered into by AT&T and Conrail on January 1, 1984, under which AT&T acquired a license over 750 miles of Conrail right-of-way, and options to acquire licenses over up to an additional 2,250 miles of Conrail right-of-way, for the purpose of installing and operating fiber optic cable (FOC) communications systems. AT&T has installed its FOC systems along approximately 2,700 miles of Conrail right-of-way, and has paid Conrail over $200 million in license fees (and is currently paying Conrail more than $17 million per year in license fees). The initial term of the License Agreement was for 15 years, but the agreement contains two 15-year renewal options. In 1997, AT&T expressed its intent to exercise its first renewal option,[1] and the renewal became effective on January 1, 1999.

The License Agreement includes a provision according AT&T "most favored nation" treatment (MFN Clause) as respects Conrail's dealings with other FOC companies. The License Agreement's MFN Clause provides, in essence, that, if Conrail enters into similar agreements with other FOC companies, Conrail will either: (1) charge each such other company at least as much as it charges

[1] The License Agreement provided that, to exercise the first renewal option, AT&T had to give written notice to Conrail by December 31, 1997. License Agreement ¶ 2.2.

AT&T under the License Agreement; or (2) lower the charges assessed AT&T down to the level charged such other companies.[2]

By decision served July 23, 1998,[3] the Board approved, subject to various conditions, a CSX/NS/Conrail "control" application that had been filed with the Board on June 23, 1997, by CSX, NS, and Conrail.[4] The CSX/NS/Conrail application contemplated the acquisition by CSX and NS of control of Conrail, and the division of the assets of Conrail by and between CSX and NS, to the extent and in the manner provided for in a "Transaction Agreement" that had been entered into by CSX, NS, and Conrail on June 10, 1997. Pursuant to Decision No. 89, acquisition of control of Conrail was effected by CSX and NS on August 22, 1998 (the "Control Date"), and the division of the assets of Conrail by and between CSX and NS was effected on June 1, 1999 (the "Split Date").

The Transaction Agreement, approved (with certain exceptions) in Decision No. 89, provided that, for purposes of the asset division that would take place on the Split Date, Conrail's physical assets would be grouped into two categories:[5] a relatively large category of "Allocated Assets," each of which would be assigned by Conrail either to its wholly owned New York Central Lines LLC (NYC)

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[2] The License Agreement's MFN Clause reads in its entirety as follows: "CONRAIL covenants and agrees that, in the event it enters into any agreement with a party other than LICENSEE providing for the use by such party of right of way owned or controlled by CONRAIL for the installation of a FOC system between any two points on the Licensed Premises, whether such system is to be installed on the Licensed Premises or parallel to the Licensed Premises, CONRAIL will, at its option, either (i) charge such other party a per mile fee at least equal to the average per mile fee (including adjustments thereto referred to in Paragraphs 3 and 4 hereof), between such two points which LICENSEE is obligated to pay CONRAIL pursuant to this License, or, in the alternative, (ii) reduce its average per mile fee between such two points to LICENSEE to the average per mile fee charged to such other party." License Agreement ¶ 11.2.

[3] CSX Corp. et al. — Control — Conrail Inc. et al., 3 S.T.B. 196 (1998) (Decision No. 89).

[4] CSX Corporation (CSXC) and CSX Transportation, Inc. (CSXT), and their wholly owned subsidiaries, are herein referred to collectively as CSX. Norfolk Southern Corporation (NSC) and Norfolk Southern Railway Company (NSR), and their wholly owned subsidiaries, are herein referred to collectively as NS.

[5] The Memorandum Opinion and Order of the United States District Court for the Eastern District of Pennsylvania, entered September 29, 2003, in AT&T Communications, Inc. v. Consolidated Rail Corporation, Civil Action No. 03-147, indicates, at page 3, that Conrail's physical assets were grouped into three categories (Allocated Assets, Retained Assets, and Shared Assets). But, there were only two categories (Allocated Assets and Retained Assets), and the assets referred to by the Court as Shared Assets were in fact a type of Retained Assets.

subsidiary (to be operated by CSXT as part of the CSX rail system) or to its wholly owned Pennsylvania Lines LLC (PRR) subsidiary (to be operated by NSR as part of the NS rail system);[6] and a relatively small category of "Retained Assets," each of which would be retained by Conrail itself, and all of which would be used by Conrail for the benefit of CSX and NS.[7] Because NYC and PRR were set up as wholly owned Conrail subsidiaries, the assignments to NYC and PRR — which were intended to incorporate the assigned assets into the CSX and NS rail systems, respectively — were coupled with provisions that gave CSXC and NSC exclusive authority to appoint the officers and directors of NYC and PRR, respectively.

The Transaction Agreement further provided that all of Conrail's various FOC contracts would be treated as Retained Assets, except that any such contract that related only to either NYC Allocated Assets or PRR Allocated Assets would itself be treated as an NYC Allocated Asset or a PRR Allocated Asset, respectively.[8] Because the License Agreement does not relate only to either NYC Allocated Assets or PRR Allocated Assets, it has been treated by Conrail (and presumably by CSX and NS as well) as a Retained Asset.[9]

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[6] By Conrail's calculations, approximately 90% of its assets were allocated to NYC and PRR.

[7] The most prominent Retained Assets are the three shared asset areas (SAAs) — the North Jersey SAA, the South Jersey/Philadelphia SAA, and the Detroit SAA — within which the post-Split Date Conrail conducts operations on behalf of CSX and NS. See Decision No. 89, 3 S.T.B. at 228.

[8] The relevant provision of the Transaction Agreement reads in its entirety as follows: "All Contracts granting any unrelated Person the right to bury fiber optic cable longitudinally along Assets shall be designated as Retained Assets (if any Assets in respect of which such rights are given are Allocated Assets, NYC or PRR, as the case may be, will license or otherwise grant rights to CRC or its Affiliates to maintain the subject matter of the Contracts granting such rights), except where such rights relate only to either NYC Allocated Assets or PRR Allocated Assets, in which case such Contracts shall be designated in the same manner as such Allocated Assets; provided that NYC and PRR shall, to the extent permitted under such Contracts that are designated as Retained Assets, be given equal access to CRC's or its Affiliate's rights to use capacity on such fiber optic cable and shall participate equally in any other benefits of such Contracts." CSX/NS-25, Volume 8B at 29 (filed June 23, 1997, in STB Finance Docket No. 33388) (Transaction Agreement § 2.2(d)) (underlining in original).

[9] Conrail indicates that the majority of the Conrail lines along which the AT&T FOC was installed were allocated to NYC and PRR. This means (if, as is usually the case, "majority" is used in the sense of "more than 50% but less than 100%"): that some of these lines were allocated to NYC; that some of these lines were allocated to PRR; and that some of these lines were retained by Conrail

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AT&T and Conrail do not agree as to Conrail's obligations, on and after the Split Date, under the MFN Clause. AT&T contends, in essence, that Conrail's obligations under the MFN Clause were not lessened by the Split Date allocation to NYC and PRR of the majority of Conrail's assets. Conrail contends, to the contrary, that, as respects the AT&T FOC installed on lines allocated to NYC and PRR, Conrail's obligations under the MFN Clause were overridden, as of the Split Date, by the immunizing force of § 11321(a).[10]

District Court Complaint. On January 10, 2003, AT&T filed, in the United States District Court for the Eastern District of Pennsylvania, a complaint seeking damages, declaratory judgment, an accounting, and other relief against Conrail in connection with Conrail's alleged violation of its obligations under the MFN Clause.[11] AT&T seeks, in particular, monetary damages for Conrail's alleged breaches of the MFN Clause, and, at AT&T's election, the right to terminate the License Agreement without further obligation to Conrail. AT&T also seeks a judgment declaring: (i) that the MFN Clause is applicable to agreements permitting third parties to use FOC on the right-of-way that is subject to the License Agreement, even if Conrail is not a party to such agreements; and (ii) that Conrail is liable to AT&T to the extent such agreements charge the licensees an average per mile fee that is less than the average per mile fee paid by AT&T for the same right-of-way. AT&T further seeks a judgment declaring that, by virtue of Conrail's breaches and repudiation, AT&T, at its election, (i) is discharged from any further obligation under the License Agreement, or, alternatively, (ii) is entitled to a reduction of its future license fees by the amount that those fees exceed the average per mile fee charged to any other licensee for the right to use the same right-of-way covered by the MFN Clause. Finally, AT&T seeks a judgment declaring that, in the event AT&T elects to reduce its future license fees (rather than terminating the License Agreement), Conrail is required to disclose to AT&T all future agreements allowing the installation of FOC on the rights-of-way covered by the MFN Clause and to

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[9](...continued)
(the retained lines are presumably located in one or more of the SAAs).

[10] Conrail contends, in essence, that, because only NYC and CSX (and not Conrail) can enter into post-Split Date FOC contracts respecting the lines allocated to NYC, and because only PRR and NS (and not Conrail) can enter into post-Split Date FOC contracts respecting the lines allocated to PRR, the preemptive power of § 11321(a) immunizes Conrail from the obligations it would otherwise have incurred under the MFN Clause as respects the AT&T FOC installed on lines allocated to NYC and PRR. Although Conrail's argument seems to suggest that the § 11321(a) immunity asserted by Conrail would not apply as respects the AT&T FOC installed on lines retained by Conrail, there are indications in Conrail's declaratory order petition (filed February 25, 2003, and discussed below) that Conrail is also asserting § 11321(a) immunity even as to lines it retained.

[11] The complaint is docketed as AT&T Communications, Inc. v. Consolidated Rail Corporation, Civil Action No. 03-147 (E.D. Pa.).

submit to an accounting of the average per mile fees paid by each licensee under each agreement that it is required to disclose.

On February 25, 2003, Conrail filed two pleadings, one with the District Court and one with the Board. With the District Court, Conrail filed a partial motion to dismiss or, in the alternative, to refer issues to the Board and to stay the entire action pending a resolution of the proceedings before the Board.

Conrail's Request For A Declaratory Order By The Board. With the Board, Conrail filed a petition asking the Board to institute a declaratory order proceeding to resolve whether the breach of contract and declaratory judgment claims made by AT&T in the court proceeding are preempted under § 11321(a) by the Board's approval of the Conrail control transaction in Decision No. 89. Conrail's declaratory order petition seeks to have the Board resolve three specific questions: (1) whether Decision No. 89 preempts any claim that Conrail breached the MFN Clause by disabling itself of its ability to perform, after the Split Date, its obligations under that clause;[12] (2) whether Decision No. 89 preempts any claim against Conrail arising from the application, after the Split Date, of the MFN Clause to FOC contracts separately entered into by CSX/NYC and NS/PRR, including any subsidiaries of those entities,[13] regarding former Conrail lines;[14] and (3) whether Decision No. 89 preempts any claim against Conrail arising from the application of the MFN Clause insofar as the post-Split Date ownership and operation of former Conrail right-of-way by CSX/NYC and NS/PRR renders Conrail's compliance with that clause commercially impossible or impracticable.[15]

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[12] This first issue is responsive to AT&T's assertion, in its complaint filed in the District Court, that Conrail "repudiated the License Agreement as a result of Conrail's disabling itself of the ability to perform its obligations under the MFN Covenant." Conrail "disabl[ed] itself," this assertion goes, by transferring most of its lines to NYC and PRR.

[13] Conrail indicates that it is referring generally to "CSX/NYC" and "NS/PRR" because it does not know which specific entities may have entered into post-Split Date FOC contracts regarding former Conrail lines.

[14] This second issue is apparently premised on the notion that, as respects the lines allocated to NYC and PRR: (i) new FOC contracts have already been entered into or will hereafter be entered into by CSX/NYC and NS/PRR, respectively; and (ii) these new contracts require or will require the new FOC licensees to pay charges that are less than the charges assessed AT&T under the License Agreement.

[15] This third issue reflects the "barter" payment arrangement contained in a 1996 FOC contract that Conrail entered into with Qwest Communications Corporation. This "barter contract," which permitted the installation of Qwest FOC along Conrail's right-of-way, provided that Qwest would

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On April 7, 2003, AT&T filed, with the Board, its response to Conrail's declaratory order petition. AT&T contends that the Board does not have "subject matter" jurisdiction over any of the claims made by AT&T in the court proceeding, and, therefore, the Board should decline to exercise its discretion to institute a declaratory order proceeding and should dismiss, with prejudice, Conrail's declaratory order petition.

On April 18, 2003, Conrail filed, with the Board, a reply to AT&T's Response and a motion for leave to file the reply. Conrail argues that AT&T has mischaracterized both the nature of the requested proceeding and the relevant jurisdictional authority.

On April 25, 2003, AT&T filed, with the Board, its opposition to Conrail's motion. AT&T opposes the motion on the ground that Conrail has not shown that good cause exists for entertaining Conrail's reply to AT&T's Response.

District Court's Referral. On October 1, 2003, Conrail filed with the Board a copy of the Memorandum Opinion and Order entered by the District Court on September 29, 2003, in Civil Action No. 03-147. The District Court denied Conrail's partial motion to dismiss and granted Conrail's motion for partial referral, sending to the Board the three specific questions raised in Conrail's declaratory order petition. The Court also granted in part and denied in part Conrail's motion to stay, granted the parties leave to conduct discovery regarding all issues arising out of contracts entered between January 1984 and June 1999, and stayed all discovery relating to contracts entered between June 1999 and the present, except to the extent such discovery is requested by the Board in aid of its determination of the preemption issue. Furthermore, the District Court directed the Board to advise the Court of its answers within 90 days of the date of the Court's order (i.e., on or before December 29, 2003), or within such longer time period as the Court might allow upon application of the Board.

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[15](...continued)
"pay" Conrail by allowing Conrail to use Qwest's FOC lines for railroad operation-related communications. Conrail is concerned that AT&T may argue that the "effective" per-mile fee paid to Conrail under the Qwest contract can be determined by the current value that the use of the Qwest FOC lines has to Conrail. Conrail contends that, because most of its assets have been divided between NYC and PRR, Conrail is now largely incapable of doing what was contemplated when it entered into the Qwest contract, i.e., Conrail is now largely incapable of using Qwest's FOC lines for Conrail's entire former network. Conrail maintains that, to the extent AT&T is asserting a claim that Conrail's inability to use Qwest's FOC lines reduces the value of the Qwest contract to Conrail and, hence, lowers the effective per-mile fee paid by Qwest to Conrail, such a claim should be preempted because Conrail's inability to realize the vast majority of the benefit of its agreement with Qwest derives directly from Decision No. 89.

PRELIMINARY MATTER

A "reply to a reply" is not normally allowed, see 49 CFR 1104.13(c), and there appears to be no reason to make an exception for Conrail's reply, which adds to the record nothing of any significance. Conrail's motion for leave to file its reply will therefore be denied.

DISCUSSION AND CONCLUSIONS

Conrail asks the Board to address whether, by virtue of the Board's authorization of the CSX/NS/Conrail control transaction, Conrail's obligations under the License Agreement's MFN Clause, as respects lines allocated to NYC and PRR, terminated as of the Split Date. Conrail further appears to ask the Board to address whether, by virtue of the Board's authorization of the CSX/NS/Conrail control transaction, Conrail's obligations under the License Agreement's MFN Clause, even as respects lines that it retained, terminated as of the Split Date.

The District Court, in referring the three specific questions raised in Conrail's declaratory order petition, has acknowledged the Board's primary jurisdiction in this matter. See the District Court's Memorandum Opinion and Order entered September 29, 2003, at pp. 21-22 (the Court ruled that referral is appropriate because the issue of whether the § 11321(a) exemption applies to a Board-authorized transaction is within the Board's jurisdiction, because the Board possesses the expertise necessary to resolve the instant dispute, and because referral will avoid the danger of inconsistent rulings). In these circumstances, the Board will exercise its primary jurisdiction over the preemption issue and will institute a declaratory order proceeding under 5 U.S.C. 554(e) and 49 U.S.C. 721.

Conrail's argument is, in essence, an affirmative defense, and, as the party raising the affirmative defense, it will bear the burden of going forward. See Consolidation Coal Sales Company v. Consolidated Rail Corporation, STB Finance Docket No. 34169 (STB served Feb. 28, 2002).

Discovery; Scheduling Conference; Alternative Formulations. No discovery is necessary because the issue presented is purely a legal one — whether Decision No. 89 preempts certain contractual rights and remedies pursuant to § 11321(a). Because there will be no discovery, there is no need to hold a scheduling conference. Finally, AT&T has requested that it be given an opportunity to submit alternative formulations of the questions to be considered. Because AT&T's "alternative formulations" go to the merits of the preemption issue,[16] AT&T will be able to use its reply pleading to reformulate the questions that must be considered.

[16] See AT&T's Response at 21 n.12 (AT&T argues that a decision on the preemption issue will require a determination "whether enforcement of the AT&T License Agreement would block the continued implementation of the Conrail Transaction.").

Timing. The District Court has asked that the Board resolve, by December 29, 2003 (the 90th day after the date of entry of the Court's order), the three specific questions raised in Conrail's declaratory order petition. To meet the Court's request for Board resolution within 90 days, the following schedule shall be adopted: 15 days for Conrail's opening submission, 15 days for AT&T's reply submission, and 10 days for Conrail's rebuttal submission.[17]

Supplemental Order Petition. As noted in the District Court's Memorandum Opinion and Order entered September 29, 2003, at p. 4, n.3, there is currently pending before the Board a petition for a supplemental order authorizing the consolidation of NYC with CSX and the consolidation of PRR with NS. See CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company — Control and Operating Leases/Agreements — Conrail Inc. and Consolidated Rail Corporation (Petition for Supplemental Order), STB Finance Docket No. 33388 (Sub-No. 94) (STB served July 9, 2003, and published at 68 FR 42159 on July 16, 2003). The parties should address in their submissions whether (and if so, how) the transaction proposed in STB Finance Docket No. 33388 (Sub-No. 94) affects the proper resolution of the three specific questions raised in Conrail's declaratory order petition.

Electronic Submission Requirement. The parties must submit, either on 3.5-inch IBM-compatible floppy diskettes or on compact discs, one electronic copy of all textual material included in their pleadings. Such textual material must be in, or compatible with, WordPerfect 10.0. The electronic submission requirement set forth in this paragraph supersedes, for the purposes of this proceeding, the otherwise applicable electronic submission requirement set forth in the Board's regulations. See 49 CFR 1104.3(b)(1).

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. Conrail's motion for leave to file a reply to AT&T's Response is denied.

2. A declaratory order proceeding is instituted. This proceeding will be handled under the modified procedure (49 CFR part 1112), on the basis of written statements submitted by the parties. Both parties must comply with the requirements contained therein.

3. Conrail shall file, by Monday, October 27, 2003, its evidence and arguments on the issues presented.

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[17] The 15/15/10 schedule will actually be a 17/16/12 schedule to accommodate weekends and holidays.

4. AT&T shall file its reply by Wednesday, November 12, 2003.

5. Conrail shall file its rebuttal by Monday, November 24, 2003.

6. A copy of this decision will be served on:

Honorable Cynthia M. Rufe, United States District Judge
United States District Court for the Eastern District of Pennsylvania
U.S. Courthouse
601 Market Street, Room # 4000
Philadelphia, PA 19106

RE: Civil Action No. 03-147 (E.D. Pa.)

7. This decision is effective on the service date.

By the Board, David M. Konschnik, Director, Office of Proceedings.

Vernon A. Williams
Secretary